FINANCIAL SERVICES/Sarbanes Substitute

SUBJECT: **Financial Services Modernization Act of 1999 . . . S. 900. Gramm motion to table the Sarbanes/Daschle substitute amendment No. 302.**

ACTION: MOTION TO TABLE AGREED TO, 54-43

SYNOPSIS: As reported, S. 900, the Financial Services Modernization Act of 1999, will reform Depression-era laws in order to eliminate barriers that prevent banks, insurance companies, and securities firms from affiliating. The bill will create a new statutory framework for the financial services industry that will increase its safety and soundness and that will give consumers more choices and lower prices.

The Sarbanes/Daschle substitute amendment would permit banks, insurance companies, and securities firms to affiliate under a significantly different and more complex regulatory plan than proposed by the bill. Key differences include the following:

- operating subsidiaries: banks would be permitted to form operating subsidiaries to provide insurance and security services (the bill will require such services to be provided through bank holding companies, with an exception for small banks; the Federal Reserve has estimated that providing services through an operating subsidiary would give a bank an estimated 14 basis points (.14 percent) competitive advantage due to benefits from the Federal Reserve Window, the Federal Wire, and deposit insurance; most large United States banks are in holding companies, which are regulated by the Federal Reserve; the Federal Reserve operates independently from political influence; individual banks are regulated by the Treasury Department);
- Community Reinvestment Act (CRA): the substitute would strike the bill's reforms and dramatically expand the CRA (the bill has two CRA reforms: the first reform will establish a rebuttable presumption that if a bank has had satisfactory CRA ratings for the past 3 years it is in compliance with the CRA; the second reform will exempt small banks from the CRA); after striking those two reforms, the Sarbanes substitute amendment would greatly expand the CRA, including by making non-compliance a violation of banking law under which individual bank officers and board members could be fined $1 million per day, by requiring compliance in order to engage in new financial activities (including insurance and security activities);

(See other side)

YEAS (54)

Republicans (54 or 100%)		Democrats (0 or 0%)
Abraham	Hutchinson	
Allard	Hutchison	
Ashcroft	Inhofe	
Bennett	Jeffords	
Bond	Kyl	
Brownback	Lott	
Bunning	Lugar	
Burns	Mack	
Campbell	McCain	
Chafee	McConnell	
Cochran	Murkowski	
Collins	Nickles	
Coverdell	Roberts	
Craig	Roth	
Crapo	Santorum	
DeWine	Sessions	
Domenici	Shelby	
Enzi	Smith, Bob	
Frist	Smith, Gordon	
Gorton	Snowe	
Gramm	Specter	
Grams	Stevens	
Grassley	Thomas	
Gregg	Thompson	
Hagel	Thurmond	
Hatch	Voinovich	
Helms	Warner	

NAYS (43)

Republicans (0 or 0%)	Democrats (43 or 100%)	
	Akaka	Kennedy
	Baucus	Kerrey
	Bayh	Kerry
	Biden	Kohl
	Bingaman	Lautenberg
	Boxer	Leahy
	Breaux	Levin
	Bryan	Lieberman
	Byrd	Lincoln
	Cleland	Mikulski
	Conrad	Moynihan
	Daschle	Murray
	Dodd	Reed
	Durbin	Reid
	Edwards	Robb
	Feingold	Rockefeller
	Feinstein	Sarbanes
	Graham	Schumer
	Harkin	Torricelli
	Hollings	Wellstone
	Inouye	Wyden
	Johnson	

NOT VOTING (2)

Republicans (0)	Democrats (2)
	Dorgan-[2]
	Landrieu-[4AN]

VOTING PRESENT (1)
Fitzgerald

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

- the substitute amendment would make it more difficult for small banks to engage in trust and fiduciary activities (which currently comprise 15 percent to 20 percent of their revenue) by making them set up operating subsidiaries or affiliates regardless of whether they intend to move into the insurance or securities markets;
- unitary thrifts (thrifts owned by commercial companies): the Sarbanes substitute amendment would bar unitary thrifts from being sold to other commercial businesses;
- Other commercial activities: banks would be allowed to hold a commercial basket for 15 years; and
- assessment rates: the substitute amendment would allow the current differential in the rate paid by thrifts and banks on certain bonds to expire as scheduled on January 1, 1999.

Debate was limited by unanimous consent. After debate, Senator Gramm moved to table the amendment. Generally, those favoring the motion to table opposed the amendment; those opposing the motion to table favored the amendment.

Those favoring the motion to table contended:

The United States' regulation of its financial services industry is out-moded. It is operating on Depression-era laws that are hampering its ability to compete in the high-technology, global economy. There is broad agreement among Democrats and Republicans that the insurance, securities, and banking industries should be permitted to compete. Also, there is broad agreement that protections need to be enacted to preserve the safety of banking deposits, which are guaranteed by Federal insurance. Last year, Congress was close to enacting an agreement that would have met these goals by allowing bank holding companies to own insurance and securities companies. That bill failed due to its extremely onerous CRA provisions. This substitute amendment before us is purportedly very similar to last year's bill. That claim is flatly false. It contains the offensive CRA provisions, and it contains many of the peripheral elements of last year's bill as well, but, on the key issue of how banks will be permitted to enter the insurance and securities fields, it is completely different.

This substitute amendment would permit any bank to open an operating subsidiary to enter those fields instead of entering them through a bank holding company as required by last year's bill and the underlying bill. This change is so immense, and so dangerous, that it would be much better to enact no reform at all than to approve it. Bank holding companies are companies that own banks. Most bank assets are in banks that are owned by bank holding companies. Bank holding companies are regulated by the Federal Reserve. The Federal Reserve is set up to be independent of political pressure. To put it in succinct, though very general, terms, its purpose is to make certain that the value of money remains stable. A stable money supply makes long-term investments and planning possible, which lead to economic growth, income growth, and new jobs. The Federal Reserve was created in the early part of this century after decades of political manipulation of monetary policy had led to numerous "boom and bust" (rapid growth and inflation followed by depression) cycles. Banks themselves are under regulation by the Treasury Department, which is under the control of political appointees. Banking policy, though, has primarily been set through Federal Reserve regulation of holding companies.

If banks were allowed to open operating subsidiaries to provide insurance and securities services, as proposed by the Sarbanes amendment, we believe that most of them would exercise that option because it would give them an immediate financial benefit. The Federal Reserve estimates that they would have a 14-basis point (.14 percent) advantage over bank holding companies that opened affiliates (and over other insurance and securities firms). In banking, a 14-basis point advantage is huge. Holding comp anies would become obsolete as assets were shifted to take advantage of this option. As a result, the Treasury Department would soon become the main regulator of the banking industry and would end up determining a large part of monetary policy. We respect the current Secretary of the Treasury, but he will not be in that post forever, and we note that the Treasury Department is always led by political appointees and is always subject to political pressure. When it was possible in the past for politicians to manipulate monetary policy for short-term gains, they did, and we believe they would do so again if they had the chance. For that reason alone we would vote against allowing operating subsidiaries and would vote against adoption of any "reform" bill that proposed them. However, that huge danger is not the only danger that would come from operating subsidiaries. They would also encourage economic concentration rather than competition. Banks that had insurance and security companies would have access to deposit insurance, the Federal Reserve Window, and the Reserve Wire, and that access would give them an unfair advantage over their competitors. As a result, we believe that most insurance and securities activities would gradually come under the control of banks. Yet another problem is that it would increase the risk for deposit insurance. Some of our colleagues like to imagine that a bank that had an insurance company that failed could be insulated from that loss, but that if the bank failed the Government could sell off the insurance company to cover deposit insurance losses. We think that the more likely result is that some banks would get involved in these other activities before they had enough competence, would suffer losses, and the taxpayers, through insurance, would end up footing the bill.

Our concerns over this amendment's CRA provisions are not as great as our concerns over its subsidiary provisions, but they are great enough that we would oppose passage of this bill if they were adopted. The CRA was passed in 1977. Under the CRA, expansions of banking activities can be prohibited if a bank does not meet CRA requirements to make loans to all groups in the surrounding community. If a challenge is made to an expansion, the expansion can be delayed while the expansion is examined.

No other enforcement mechanism for the CRA exists. Based on these seemingly innocuous requirements, a huge regulatory scheme has been erected, and an extortionist industry has been spawned.

Banks are regularly audited to see if they are in compliance, and the cost of meeting the regulatory burden is high, especially for smaller institutions. The average cost for a small rural bank of being audited, for example, is between $60,000 and $80,000. Since President Clinton has been in office, more than 16,000 such audits of rural banks have been conducted; for all of that effort, only 3 banks have been found in substantial non-compliance, and only 70 have been found to be just marginally out of compliance. One of the reforms of this bill will therefore be to exempt small banks from the CRA. This amendment would strike that reform.

The extortion that has been created by the CRA is based on the ability of protestors to delay bank expansions using the CRA. Pre-Clinton, the CRA was rarely used for this purpose. From 1977 to 1991, CRA challenges led to settlements under which banks agreed to invest a total of $42 billion as requested by protestors. Since 1991, though, the CRA has been used extensively by a few well-organized groups to challenge bank mergers and other expansions. Such challenges can result in millions of dollars in lost revenue each day for the banks involved, and the protestors know it. If they completely block expansions, they can cost companies billions or tens of billions of dollars. Banks have negotiated, and according to the protest groups, they agreed as of last year to spend $694 billion over the next 10 years as demanded in order to get protestors to drop their CRA challenges. Most egregiously, those deals included cash payments, or more accurately pay-offs, to the protestors of more than $9 billion. The radical left has found a new cash cow. They do not need any evidence for charges of discrimination; all they need to do is level their charges. To stop abuses of the CRA, this amendment would adopt a very modest reform. It would provide that if a bank had three successive satisfactory CRA ratings, meaning that it was making loans throughout its community, then a rebuttable presumption would be made that it was in compliance. That presumption would mean that any challenge would have to be based on substantial evidence, which is a carefully defined term under case law, of a CRA violation. Under case law, substantial evidence must be "more than a scintilla" of evidence that a "reasonable mind" would conclude constituted a violation. This amendment would strike that very modest reform.

The amendment would not stop with striking this bill's CRA reforms. It would then make it a banking violation to be out of compliance with the CRA (which could hold individual bank officers liable to fines of up to $1 million per day), and it would expand the CRA to cover new institutions, including institutions that do not even have deposit insurance (the original justification for passing the CRA was that it was reasonable to demand a public service from the banks because they were receiving a public benefit from deposit insurance).

Our disagreements with this substitute amendment do not stop with its subsidiary and CRA provisions. For instance, we also have very strong objections to its unitary thrift provisions. Overall, though, we do not want to leave the impression that we are in total disagreement with our colleagues. There is still a very broad consensus on the results that should be achieved from financial modernization. The disputes are on how best to achieve those results. We are hopeful that compromises will be reached. The provisions of this substitute amendment, though, are not compromise provisions. We urge the rejection of this amendment.

Those opposing the motion to table contended:

The bill before us was reported from the Banking Committee on a straight, party-line vote. The President has threatened to veto it, and that veto would be sustained. Following the present course will serve to highlight partisan differences, but it will not result in the enactment of legislation. We do not need to follow this dead-end course. There is broad agreement on the need for reform, and bipartisan proposals have been advanced. The House has a bipartisan plan, and the Senate had a bipartisan plan last year. We still hope that the Senate will be able to find a bipartisan compromise that the President and the House will support as well.

The Sarbanes substitute amendment would largely follow the bill that was reported by the Senate Banking Committee last Congress, except that it would change the provisions regarding how banks would be permitted to provide insurance and securities services. Our colleagues object mainly to those changes and to the restoration of the CRA provisions from last year's bill. The Sarbanes amendment would allow banks to provide insurance and securities services through subsidiaries rather than through holding company affiliates. This change would bring several benefits. First, it would strengthen deposit insurance, because if a bank were to fail the Government could then take profits from the insurance and securities companies, or could sell those companies, to help cover losses. Under a holding company structure, the profits do not go to the bank, but to the holding company. Banks would also be helped by the fact that it is generally cheaper to operate subsidiaries rather than to create holding companies. We note also that the Clinton Administration has recommended that the bill be vetoed unless we adopt this structure. Some of us initially were concerned that this arrangement could end up with the Treasury Department rather than the Federal Reserve being responsible for most banking regulation (the Federal Reserve regulates holding companies; the Treasury Department regulates individual banks), and we were also concerned that this arrangement could end up with banks being put at risk if their subsidiaries failed. However, new safeguards have been added to the bill to keep the Federal Reserve involved in certain areas of regulation, and rules have been adopted to keep banking activities and required capitalization assets strictly separated from subsidiaries. These changes, which we believe are significant compromises, make us supportive of the affiliation provisions in this substitute amendment.

The CRA provisions of this amendment are the main reasons we were not able to pass last year's reform bill. Though they had, and have, bipartisan support, they are strongly opposed by a minority of members who were able to kill the bill last year through a filibuster. The CRA simply requires banks to lend to the communities from which they draw deposits. Before the CRA existed, it was common for some banks, especially in minority, urban areas, to have substantial deposits from local people but to generally deny loans to those same people. Since the CRA has been in existence, local lending has increased substantially, but it has not caused losses; banks have been able to make profits while meeting CRA mandates. In fact, the CRA does not require banks to lend if the borrowers do not meet qualifications. Basically, what it has done has been to force banks to recognize an opportunity for making money that they were overlooking. Our colleagues' oppose the CRA because they believe that is has been used in an extortionist manner. They do not have anything more than sparse, anecdotal evidence of abuses. Based on those anecdotes, though, they want to gut the CRA by creating a "safe harbor" that would make it almost impossible for anyone to challenge a bank's CRA rating. We favor going in the other direction. The CRA has worked well and should be expanded as proposed in the Sarbanes amendment. Abuses should not be tolerated, and we are open to having hearings on this issue to find out if there really are abuses and, if there are, to devise ways to end them. We will not support gutting the CRA based on flimsy evidence, though.

Other improvements in this amendment include that it would not allow unitary thrifts to be sold to commercial companies and that it would enact more consumer protections than the underlying bill. Perhaps the greatest improvement, though, is that it contains provisions that we think could pass the House and be approved by the President. If our colleagues truly want to enact legislation this year rather than just highlight partisan differences, they will vote in favor of this amendment.